**Manufacturing Matters: California's Performance and Prospects and
The Economic Impact of a Sales Tax Reduction on Manufacturing Equipment**

Prepared by the Milken Institute
for the California Manufacturers & Technology Association

Summary

California has lost nearly 10% of its manufacturing workforce since January 2001, the most recent evidence of businesses in the state struggling with an unfriendly regulatory environment and cost structure that is now 32% higher than the national average. Since the early 90's, the growth of high-tech manufacturing overcame losses in aerospace and other traditional manufacturing employment, temporarily masking this underlying weakness in California's industrial climate. But now that the bubble has burst in high-tech, cost pressures are again driving those and other California manufacturers to lower-cost states and countries.

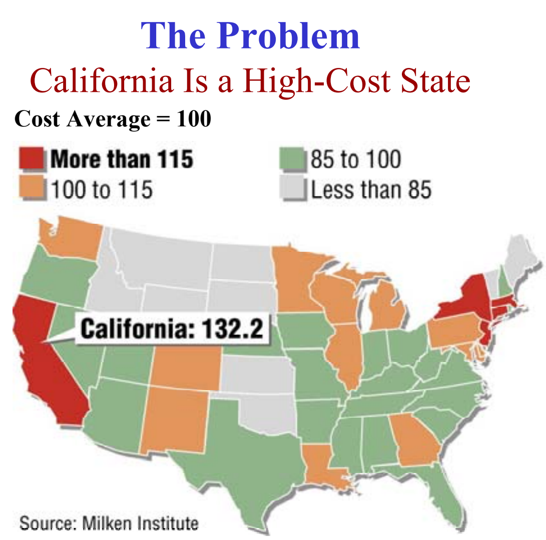
Manufacturing Matters describes the importance of manufacturing employment in California and how, unless state policymakers take corrective action, the continued loss of manufacturing jobs will be felt in the years to come – lower average wages, loss of upward mobility, fewer jobs in service sectors of the economy, and a decline in innovation and new ideas that are the wellspring of economic growth.

The Economic Impact of a Sales Tax Reduction on Manufacturing Equipment, a companion study to Manufacturing Matters, describes the state tax revenues and job growth benefits of a 5 percent reduction in the sales tax paid for the purchase of machinery and equipment used in manufacturing and research and development.

California Competitiveness is Threatened by High Costs of Doing Business

- California has the third highest overall cost of doing business in the United States, 32% above the national average and highest in the west. Other states and countries are actively poaching California manufacturers, highlighting their lower business costs, particularly electricity and tax rates, and offering attractive location incentives.

- California's tax burden is approaching levels that make it difficult for manufacturers to produce their products at profitable levels given the immense competitive pressures stemming from globalization. In the last decade, nearby states have lowered their tax burden an average of 7.8 percent. In contrast, California has seen a nearly 4 percent *increase* in its tax burden.



- Electricity costs in California have been higher than most states for many years, but the recent electricity crisis – and the subsequent disproportionate rate hikes on industrial users – increased it's costs even more. Electricity costs are nearly double the national average. Other western states have endured only moderate changes in their electricity costs.

- California's cost factors inadvertently confer a distinct competitive advantage to nearby western states with advanced manufacturing capabilities. Manufacturers interested in accessing California's large business and retail markets can easily do so from these geographically proximate states.

California's Workforce is Threatened

- The size and health of the middle class depends on manufacturing employment. The average wage for a manufacturing job in California is $25,000 higher than that of a service sector employee. Retail trade wages average $35,000 less than manufacturing wages.

- Manufacturing provides well-paying jobs with upward mobility. Manufacturers provide training opportunities for entry-level workers, often of ethnic diversity, and provides the opportunity to move into higher-skilled or management positions. A manufacturing job is a means to enter the middle class and to send sons and daughters to post-secondary education. In order to reduce the gap between the haves and the have-nots in California, it is important that state policy officials recognize manufacturing's role in creating higher paying jobs for its citizens.

- For every one new manufacturing job, an additional 2.5 jobs are created in the broader economy - the highest multiplier effect of any job classification. By the same token, a loss of one manufacturing job takes an additional 2.5 jobs with it.

Loss of Manufacturers Threatens California's Economic Development Prospects

- Manufacturing processes are often the source of new ideas and innovation in product development and design. The single greatest technical innovation to come out of Silicon Valley, the microprocessor, was created through manufacturing process improvements.

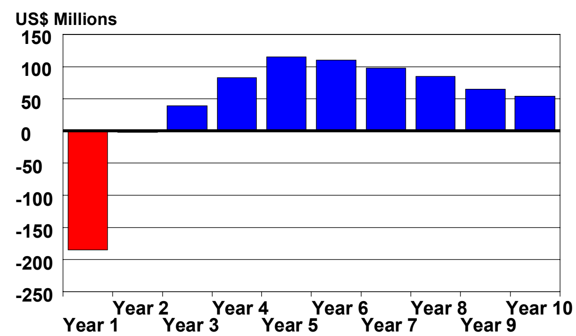
- Those parts of the US and the world that are acquiring the manufacturing capabilities that California keeps relinquishing are strengthening their potential to create the sorts of innovations that once characterized the Golden State.

Call to Action

- Policy makers should adopt new legislation and regulations to reduce costs and provide incentives for manufacturers. They should attend to three primary factors affecting California's ability to attract and retain manufacturers: the perception that California is not a business friendly state, the impact of overly restrictive regulations and high costs on manufacturers, and the value of incentives to overcome negative impacts of restrictive regulations and high costs for manufacturers.

Projected State Net Revenues

Change in Net Revenues From a 5 Cent Sales Tax Reduction



- California should exempt the purchase of machinery and equipment used in manufacturing and research and development from the 5 percent sales tax imposed by the state. A dynamic modeling of this change shows that a first year loss in tax revenues is quickly overcome by increased tax revenues from higher economic activity. By the fifth year the state enjoys a net gain of $114 million and $75 million per year thereafter is added to the state coffers. An average of 50,000 new jobs each year are also added to the economy.

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